



WEEKLY REPORT

ARIZONA STATE RETIREMENT SYSTEM

Paul Matson, Director
3300 North Central Avenue, Phoenix, Arizona 85012
www.asrs.state.az.us

ASRS Board

Mr. Alan Maguire, Chairman
Ms. Bonnie Gonzalez, Vice Chairman
Ms. Charlotte Borchert
Mr. Jim Bruner
Dr. Chuck Essigs
Mr. Norman Miller
Mr. Karl Polen
Mr. Ray Rottas
Mr. N. Carl Tenney

For the week ending Friday, January 17, 2003

Welcome to the first edition of this legislative session of the Arizona State Retirement System Weekly Report. You will receive this report each week. It will summarize legislation that pertains to the ASRS, as well as keep you up-to-date on ASRS news! We hope you find it useful. Future issues will include summaries of legislation, along with a handy matrix for quick reference. If there are issues you'd like addressed, please let us know!

***** Please distribute or make available this report to your employees! *****

Recent ASRS News:

The ASRS Board announced Dec. 24, 2002 the appointment of Paul Hugh David Matson to Director of the agency. Mr. Matson replaced LeRoy Gilbertson, who retired as director on Jan. 6, 2003. Mr. Matson had been serving as chief investment officer of the ASRS prior to the appointment.

Other recent additions to the ASRS staff include:

- Terry Cusker, as Assistant Director for Member Services
- Gary Dokes as acting Chief Investment Officer
- Patricia Hill as Government Relations Officer
- David Cannella as Communications and Media Relations Manager

ASRS Legislative Policy Initiatives

Status as of January 15, 2003

On December 20, 2002, the Arizona State Retirement System (ASRS) Board proposed the following legislative policy initiatives (Bills) for the 2003 legislative session.

ASRS; Legal Counsel; Exemption

Arizona Revised Statutes 41-192 provides that the Attorney General shall "... be the legal advisor of the departments of this state and render such legal services as the departments require..." Additionally, A.R.S. 41-192 provides that no state agency other than the Attorney General shall employ legal counsel or make expenditures or incur indebtedness for legal services. However, A.R.S. 41-192 exempts nine boards, commissions, agencies and other entities that are from this limitation and allows them to retain independent legal counsel.

Issue: The ASRS addresses very technical policies and procedures relating to the investment and distribution of billions of dollars belonging to public employees. Consequently, legal counsel must have a very specialized

background to provide legal advice to the ASRS Board as it sets policies regarding the investment and oversight of the ASRS funds. The ASRS legal counsel must function independently of electoral and other political cycles to assure that the ASRS system has continuity and consistency in its legal advice. Allowing the ASRS to retain specialized legal counsel would provide the ASRS with necessary tools to better serve our members' needs.

Proposal: Amend A.R.S. 41-192 to allow the ASRS to retain independent legal counsel.

Status: Senator Dean Martin has agreed to sponsor the legislation. Legislative Council has drafted the bill.

* * *

Contributions Not Withheld; Interest; Time Limits

Employers occasionally fail to make retirement plan contributions to the ASRS for qualified employees. Existing statutes (A.R.S. 38-738 B) provide an opportunity for employers that did not withhold or remit contributions for an employee to correct such errors. To correct a failure to make the required contributions, both the employee and the employer must pay their portion of the contributions due. Additionally, A.R.S. 38-738 (B) (3) provides that the employer is responsible to pay the "...accumulated interest that would have accrued on both the employer and member contributions due...." The employee and the employer both pay their due amounts directly to the ASRS.

Issue: Many employees do not take responsibility for ensuring their account information is correct until the time of retirement. Inaccurate account information may result in an extensive period, 30 years or more in some cases, for which the employer is responsible for the accrued interest on both the employer's and employee's unpaid contributions. A reasonable limit to the length of time that the employer is responsible for accrued interest and an incentive for employees to come forward in a timely manner would help to remedy this situation.

If the employer remits the total amount they owe, there is no incentive for the employee to remit their amount due in a timely manner. The statutes do not provide for the accrual of interest on an unpaid amount the employee may still owe after the employer pays.

Existing statutes do not provide guidance as to whether the employer or employee has the responsibility to verify that the employee was eligible to participate in the ASRS. Some of the periods of employment in question may be more than 30 years past.

Proposal: Amend A.R.S. 38-738 to:

- Encourage employees to pay in a timely manner by charging the employee interest on the amount they owe, beginning 90 days after notification that the employer has paid.
- Encourage employers to pay in a timely manner by charging the employer interest on the amount they owe, beginning 90 days following notification by the ASRS of the amount due.
- Limit the potential liability of the employer for interest accrual to a maximum of 15 years prior to the date the ASRS is notified that less than the correct amount of contributions was paid to the ASRS.
- Provide that the employee can purchase verified service time that is more than 15 years prior as Other Public Service Non-participatory, pursuant to A.R.S. 38-743.
- Specify that the employee is responsible for verifying eligibility.
- Provide a delayed effective date of July 1, 2004, to allow a one-year period for employees to reconcile their accounts before the 15-year limitation is imposed.

Status: Representative John Huppenthal, chair of the House Government and Retirement Committee, has agreed to sponsor the legislation. HB 2023 ASRS; unpaid contribution, was introduced on Monday, January 13th and was assigned to House Government and Retirement, House Appropriations and House Rules. It was heard on Tuesday morning in the House Government and Retirement Committee and should be on the January 21 House Appropriations Committee.

Modified Drop; Conforming Changes

Section 415(n) of the federal Internal Revenue Code allows the purchase of “permissive service credits” in a governmental plan. These permissive service credits include other public service, leaves of absence and military service. Section 415(n) also allows the purchase of “air time.” Air time is time that can be purchased as credited service toward the members retirement account even though the employee did not actually work that time. Pursuant to section 415(n), the member must have been an active member in a governmental retirement plan for at least five years to be eligible to purchase “air time” and the amount of “air time” that may be purchased may not exceed five years.

A.R.S. 38-748 establishes a Deferred Retirement Option Plan (DROP) program that allows an employee, who has attained a normal retirement age, to enter into a DROP agreement of up to 36 months with their employer. A.R.S. 38-748 (B) (2) and A.R.S. 38-748 (C) require the participating employee to purchase an amount of service credit equal to the amount of time worked under the DROP agreement. Additionally, A.R.S. 38-748 (B) (1) awards the employee up to 36 months of credited service for work performed under a DROP agreement if all terms of the agreement are completed (A.R.S. 38-748 (D)). The service credit purchased pursuant to A.R.S. 38-748 (B) (2) would be considered “air time” within the definitions of Section 415(n) of the Internal Revenue Code.

Issue: Current law does not address the following issues related to the implementation of the program:

- A.R.S. 38-748 does not currently comply with the federal requirement for a member to have been an active member of a government retirement plan for at least five years prior to being eligible to purchase “air time.”
- A.R.S. 38-748 establishes a maximum period of 36 months for a DROP agreement. However, it does not establish a minimum period for such an agreement. A.R.S. 38-748 (A) states that it is the intent of the DROP program “to encourage active members to continue to work beyond normal retirement age...” It is therefore reasonable to have a minimum period for participation in a DROP agreement.
- A.R.S. 38-748 provides that the employer and employee shall not make “contributions” to the ASRS for the period of the agreement. However, it does not distinguish between ASRS pension contributions and Long Term Disability (LTD) contributions. The employee would continue to be covered by LTD, and it is essential that provisions be made to allow for LTD contributions to continue to be made to the ASRS.
- A.R.S. 38-748 (D) provides that an employee who does not complete the terms of the DROP agreement forfeits any credited service that may be provided by the agreement. However, if a member is unable to complete the agreement due to permanent disability or death, it is reasonable to allow them or their beneficiary to purchase credited service for the period of the agreement that they successfully completed.
- R.S. 38-748 does not provide clear guidance as to whether the employee’s current annual salary at the time of entering the DROP agreement or at the time of completing the DROP agreement should be used to calculate the cost of purchasing service credit allowed pursuant to 38-748 (B) (2).
- A.R.S. 38-748 does not provide any limit to the total number of years of “air time” that may be purchased pursuant to (B) (2) through multiple DROP agreements with multiple employers, whereas the Internal Revenue Code provides for a maximum of five years.

Proposal: Amend A.R.S. 38-748 to provide that:

- A member must have at least five years participation in the ASRS to be eligible to participate in the DROP program pursuant to A.R.S. 38-748 and to purchase credited “air time” pursuant to A.R.S. 38-748 (B) (2).
- DROP agreements shall be for a minimum of six months.
- Employers and employees shall continue to make LTD contributions to the ASRS during the DROP period.

- If a member is unable to complete the terms of a DROP agreement due to permanent disability or death, the member or the member's beneficiary may complete the purchase of credited service for the period of the agreement that was successfully completed.
- The current annual compensation at the time of entering a DROP agreement shall be used to calculate the cost of purchasing credited service allowed pursuant to A.R.S. 38-748 (B) (2).
- A maximum aggregate of five years of "air time" may be purchased pursuant to A.R.S. 38-748 (B) (2).

Status: Representative Huppenthal has agreed to sponsor the legislation. ASRS staff is working with House Research staff to develop criteria to be included in an agreement between an employer and an employee to enter into a DROP.

* * *

Service Purchase; Clarification

A public employee participating in the ASRS may pay the full cost (present value) of previous service with another public employer or the military and have that amount of service credited to their ASRS retirement account. A.R.S. 38-743 (B) and 38-745 (B) define the methods that the ASRS uses to determine the cost of purchasing service credit as "...the amount equal to the product of the member's current annual compensation times the normal cost rate...." A.R.S. 38-711(7) defines "compensation" as, "...the gross amount paid to a member by an employer as salary or wages....," and A.R.S. 38-711 (5) prescribes the formula to calculate the "average monthly compensation." However, "current annual compensation" is not defined in statute.

Issue: The absence of statutory guidance as to the meaning of "current annual compensation" leaves the process of purchasing credit for past service open to possible abuse that may result in under-compensating the retirement fund for the benefits derived. Under-compensating the fund would ultimately require others to pay for those benefits, possibly through higher contribution rates.

Example: A highly paid individual may take lower paying, short term employment for the sole purpose of establishing a temporary, lower compensation rate for use in calculating the cost of their purchase of past public service or military service. After completing the purchase based on the reduced salary, the member may then apply for retirement benefits based on their previous, higher salary (highest 36 months out of the last 120 months worked). The result is that the employee has purchased their service time for a deeply discounted cost, and the fund, employers and employees bear the burden of paying the difference for the discounted price.

Proposal: Amend A.R.S. 38-711 by adding a definition of "current annual compensation" that ensures that members participating in the service purchase program pay the full and fair amount to compensate the fund for the benefits received. Include an emergency clause on the bill so the change becomes effective upon the date of the Governor's signature.

Status: The legislation was sponsored by Representative Huppenthal in the House and Senator Martin in the Senate. HB 2024 ASRS; service purchase; calculation was introduced on Monday, January 13th, and was assigned to House Government and Retirement, House Appropriations and House Rules. HB 2024 passed the House Government and Retirement Committee unopposed on January 14. It should be heard in House Appropriations on Tuesday, January 21.

* * *

Technical changes; terminology

A.R.S. 38-718 (3) presently contains language pertaining to investment advisors holding the chartered financial analyst designation awarded by the Institute of Chartered Financial Analysts (ICFA). In January 1990, the ICFA and the Financial Analysts Federation (FAF) merged to form the Association for Investment Management and Research (AIMR). AIMR now administers the chartered financial analyst program.

Issue: Existing statutory language refers to the “institute of chartered financial analysts” which is now known as the “Association for Investment Management and Research.”

Proposal: Amend A.R.S. 38-718 (3) to correct for the change in the name of the organization responsible for awarding the chartered financial analyst designation.

Status: Senator Martin has agreed to sponsor the bill. Legislative Council has agreed to sponsor the bill.

**The weekly legislative report is available on-line at the ASRS Web site:
www.asrs.state.az.us**

The ASRS External Affairs Division and the Legislative Board Committee meet regularly during the legislative session. The meetings are held in the 14th floor conference room of the ASRS office located at 3300 N. Central Avenue, Phoenix, AZ., and are open to the public. The purpose of these meetings is to review legislative activity on retirement bills from the previous week, and to review the scheduled bill activity in committees and on the floor for the upcoming week. Committee members ask technical and background questions, and reviews the latest information gathered from the Capitol and retirement groups from around the state. The meeting is teleconferenced to the ASRS Tucson office located at 7660 E. Broadway Boulevard, Tucson, AZ. Meeting agendas and minutes will be posted on the ASRS website.

If you have questions relating to legislation, please call Patricia Hill at (602) 240-2027 in metro Phoenix, (520) 239-3100 extension 2027 in metro Tucson, or (800) 621-3778 extension 2027 outside metro Phoenix and Tucson.